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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC

SECTION 701 REPORT	Docket No. PI2016-3

COMMENT OF THE
NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO

Pursuant to the Commission's April 14, 2016 notice and order in the above case, the National Association of Letter Carriers, AFL-CIO ("NALC") hereby submits this comment for consideration by the Commission in the preparation of its report to Congress under Section 701 of the Postal Accountability and Enhancement Act.

NALC wishes to address it comments to the first area of interest identified in the April 14 Order -- regarding the Postal Service's financial condition.

There are two significant legislative/regulatory burdens placed on the Postal Service by the Postal Accountability and Enhancement Act (PAEA) of 2006 that have damaged the Postal Service's financial situation. Both should be removed, addressed or reformed by Congress.

The Pre-funding Mandate

The most significant burden imposed by PAEA is the provision that requires the Postal Service to massively pre-fund future retiree health premiums -- decades in advance. Congress adopted this mandate in the most inflexible manner possible. It required the Postal Service to make 10 fixed payments of between $5.4 billion and $5.8 billion annually between 2007 and 2016 – regardless of its financial condition or the state of the economy -- and then to begin making actuarial-based pre-funding payments over 40 years, beginning in 2017.

The actuarial-based payments are comprised of two parts: a normal cost payment to cover the future cost of retiree health accrued each fiscal year, and a payment calculated to amortize any remaining unfunded liability over the next 40 years. Together these payments will exceed $6.0 billion annually starting in 2016. In other words, in the absence of legislative change, the cost of pre-funding is actually expected to increase after 2016 as a result of these actuarial-based payments – beyond the unaffordable levels of recent years.

No other enterprise in America (public or private) faces a legal mandate to pre-fund future retiree health insurance benefits – though Congress does appropriate money to the Department of Defense to partially pre-fund such benefits for certain Pentagon retirees. According to an annual survey of Fortune 1000 companies by Towers Watson, only 38 percent of such firms pre-fund retiree health at all, and 62% do not pre-fund at all. (See Perspectives: Accounting for Pensions and Other Post-Retirement Benefits, 2015.) Those companies that voluntarily pre-fund typically make contributions only when the companies are profitable.

The Postal Service pre-funding payments, which could not be suspended when the Great Recession hit, were so onerous that the Postal Service exhausted its $15 billion borrowing authority in order to make the payments. Since 2012, it has not been able to make the payments at all – though the expenses associated with the missed payments have continued to be recognized, driving the Postal Service deep into the red. All told, $51.9 billion of the Postal Service's reported losses of $58.5 billion since 2007 – 89% -- are due to the pre-funding mandate. See Attachment #1.

The damage this policy has inflicted goes way beyond the adverse financial effects. This policy has starved the Postal Service of needed investments, most notably the urgent need to replace its obsolete fleet of vehicles. It has also caused the Postal Service to excessively down-size in ways that are short-sighted and counter-productive. For example, the Postal Service made it more difficult for Americans to access its services by removing tens of thousands of mail collection boxes; slashing the operating hours of thousands of post offices; and reducing its service standards in order to dramatically downsize its network of mail processing plants. The quality of service has suffered – and we fear the Postal Service has driven significant business away as a result.

Over the years, NALC has suggested a number of legislative measures to address the crisis caused by the pre-funding mandate – for example, repealing the mandate, making it more flexible and contingent on USPS profitability, reducing the pre-funding target percentage to match private sector best practice (33%-50% pre-funding) or adopting private sector pension valuation standards so that USPS pension surpluses could be transferred into the Retiree Health Fund. More recently, NALC, the other postal unions and major portions of the mailing industry have reached consensus on a way to address the pre-funding burden by reforming the Federal Employee Health Benefit Program (FEHBP) as it relates to postal employees. Further integrating FEHBP retiree health benefits coverage with Medicare coverage would mimic standard private sector practice and all but eliminate the unfunded liability for future retiree health. This could be achieved by: (1) reforming FEHBP to segregate postal employees and annuitants into their own risk pool (separate from the active and retired employees of other federal agencies); (2) increasing participation by Medicare-eligible postal annuitants in Medicare Parts A and B; and (3) requiring the new postal-only FEHBP plans to offer Postal Service annuitants and family members who are eligible for Medicare Part D though a prescription drug plan offered under a waiver under section 1860D-22 of the Social Security Act (42 U.S.C. 1395w-132).

In its Section 701 report, the Commission should support all of these options for alleviating the pre-funding burden. In the context of targeted postal legislation that does not weaken the Postal Service's networks or diminish services to the public, NALC would support any of these approaches.

Restrictive investment policies for postal retirement funds

In general, the Postal Service has incredibly well-funded retirement plans, although declining interest rates in recent years have inflated liabilities and created temporary unfunded liabilities. At the end of 2014, the Postal Service's CSRS and FERS pension funds were 92.4% funded – well into the healthy "green zone" under the private sector Pension Protection Act and much better than the 81.7% funded percentage for the 100 largest pension plans according to the 2015 Pension Funding Survey conducted by the Milliman Company. (The USPS funded percentage at the end of FY 2015 was 92.2 percent.) At the same time, while the median level of funding for retiree health benefits among Fortune 1000 companies is zero percent (0%), the Postal Retiree Health Benefit Fund is nearly 50% funded.

These strong funding positions are all the more remarkable given the restrictions placed on the investment of the Civil Service Retirement and Disability Fund (which holds the federal and postal accounts for both CSRS and FERS) and the Postal Service Retiree Health Benefits Fund (PSRHBF). By law, the pension funds and the PSRHBF must be invested in low-yielding Treasury bonds. Together, the CSRS and FERS postal accounts and the PSRHBF hold nearly $340 billion in Treasury securities – making the Postal Service and its employees the third largest creditor of the U.S. federal government just behind the governments of China and Japan. No private company in America would invest 100% of their pension and post-retirement health funds in such a conservative way, especially during a period when Treasuries are yielding 2-4% returns. When your investment time horizon stretches out over decades, best practice in the private sector is to invest in a well-diversified portfolio of private sector stocks, bonds and real estate as well as government bonds. Such a portfolio is provided by the Thrift

Savings Plan's Lifecycle 2040 Fund. If the Postal Service's FERS and CSRS accounts could have been invested in the 2040 Fund between 2007 and 2014, their combined balance would be $32 billion greater today – enough to cover the total combined unfunded liability of $23 billion in 2014.

Although the policy of investing all USPS and employee contributions toward postal pensions in Treasury bonds predates the PAEA, that policy was followed by the PAEA in its measure creating the PSRHBF. At a minimum, Congress could and should direct the Office of Personnel Management to invest the Postal Service Retiree Health Benefits Fund the way a private sector company would invest such a fund – again, in a well-diversified portfolio of private sector stocks and bonds as well as government securities modeled on the index funds available through the federal Thrift Savings Plan (TSP).

This policy change is entirely appropriate. The PSRHBF is a stand-alone, one-agency trust fund in the U.S. government's accounts. Its assets are funded by postage rate-payers to cover the cost of future retiree health insurance premiums payable by the Postal Service. The cost of these premiums, like medical services in general, is expected to rise by 5.0-7.0% annually over the next several decades. It makes no financial sense to invest in assets that yield less than the trend rate of medical inflation. The PSRHBF investment policy in current law – which effectively mandates a low-cost loan from business mailers to the Federal government -- unnecessarily raises the cost of pre-funding and puts pressure on the Postal Service to raise postage rates or to cut services.

There is a better way. Congress could raise the long-term rate of return on the retiree health fund's assets, improve the overall finances of the federal government (OPM's balance sheet), reduce the burden of pre-funding, relieve upward pressure on postage rates, and lessen the threat of misguided service cuts by making one change: It could direct the OPM to invest PSRHBF assets in safe, low-cost index funds of the kind offered by the TSP. As the table below indicates, had the fund's assets been invested in the Lifecycle 2040 Fund of the TSP since 2007, its value would be nearly $60 billion–nearly $11 billion more than its actual balance. (The latest official valuation reflects the end of FY 2014.)

Postal Service Retiree Health Benefits Fund: Assets and Earnings ($mil.)

Year	Annual Prefunding Payment ($mil.)	Investment Income ($mil.)	PSRHBF Year-End Balance (1) ($mil.)	Rate of Growth	L Fund 2040 returns	Projected PSRHBF year-End Balance if invested in L2040 Fund ($mil.)
2007	$5,400	$287	$25,745	--		
2008	$5,600	$1,265	$32,610	4.9%	-31.53%	$23,235
2009	$1,400	$1,472	$35,482	4.5%	25.19%	$30,488
2010	$5,500	$1,510	$42,492	4.3%	13.89%	$40,223
2011	$0	$1,626	$44,118	3.8%	-0.96%	$39,837
2012	$0	$1,626	$45,744	3.7%	14.27%	$45,693
2013	$0	$1,548	$47,292	3.4%	23.23%	$56,308
2014	$0	$	$48,850	3.3%	6.22%	$59,810

Notes:

(1) Explanation (from pg. 26, 2007 Annual Report): The initial balance in the PSRFB resulted from two transfers: a) the postal surplus in the CSRS Fund as of September 30, 2006 ($17.1 billion transferred on June 29, 2007); and b) the funds held in the escrow account established by P.L. 108-18 ($2.958 billion). The first pre-funding payment of $5.4 billion was also made in 2007.

To demonstrate how beneficial this change in investment policy could be, NALC engaged consultants at the Lazard Co. in New York to investigate the potential impact of investing the PSRHBF the way many other trust funds are invested at the federal and state level. They found such funds -- including pensions for Amtrak workers and state employees of New York and California, as well as other trust funds managed by the Pension Benefit Guarantee Corporation and the National Railroad Retirement program -- routinely invest in private sector stocks and bonds as well as Treasury securities. Lazard found that if the PSRHBF had been invested the way these other public trust funds were invested between 2007 and 2104, its assets would have been worth $5 - $7 billion greater than it was at the end of FY 2014 (see Attachment #2). They concluded that if this investment reform were adopted along with the FEHBP reforms and Medicare integration outlined above, the PSRHBF could be fully funded within a few years.

While no trust fund invested in a diversified portfolio of stocks and bonds achieves its long-term target rate of return every year and sometimes even loses money in market downturns, the Lazard analysis shows that the PSRHBF could be fully funded over the long run. Over time, such an investment policy might eliminate the need for any amortization payments and could justify the suspension of normal cost payments as well.

There are two common objections to this investment proposal: (1) the risk of loss associated with investments in private stocks and bonds; and (2) the long-standing policy of the Treasury Department against investing government trust funds (such as the Social Security Trust Fund) in private securities. Neither of these objections should hold in the case of the PSRHBF.

First, given the long investment horizon of the PSRHBF and the relatively modest annual outlays from the fund ($3.0-$4.0 billion for the foreseeable future), the risk of a short-fall in a prudently invested PSRHBF is extremely small. In fact, the OPM projects future retiree health liabilities over a period of 90 years. So the Fund would have decades to make up for any sharp losses. Indeed, the experience of the L 2040 Fund since the 2008 financial crisis provides a real life test of this resiliency. The L 2040 Fund has more than bounced back from the 2008 stock market crash.

Second, although the Treasury has traditionally invested government trust funds only in government bonds, the PSRHBF is a different kind of trust fund and there are several government entities that regularly invest in private securities.

The PSRHF is different from most trust funds because it does not involve federal taxpayer dollars. The funds in the PSRHBF come from postage rate-payers. They are collected to cover the cost of services rendered. As with the assets of the TSP's index funds, the PSRHBF is dedicated to providing post-retirement benefits for federal employees – in this case, the employees of the U.S. Postal Service. Although it is the only trust fund dedicated to cover the retiree health benefits of a single agency's employees, there are other retirement funds controlled by primarily self-funded federal agencies that are allowed to invest in private sector securities. These include: the National Railroad Retirement Investment Trust (NRRIT), the Pension Benefit Guarantee Corporation (PBGC), Amtrak and the Tennessee Valley Authority (TVA).

The ratepayer funds held by the postal retiree health fund should be invested the way these other agencies invest their funds. The OPM should hire well-qualified asset managers, chosen by trustees with fiduciary responsibilities to invest the fund wisely – maximizing returns while minimizing risk and investment fees.

Properly investing the PSRHBF's assets will, over the long run, improve the balance sheet of the OPM and reduce the cost of pre-funding for the Postal Service. This will allow for affordable postage rates and better service to America's mailers and citizens. If the purpose of the Fund is to protect taxpayers against the need to cover future health care costs for retired postal employees, the best way to reduce that need is to invest the PSRHBF prudently and intelligently. Investing it in private sector securities (stocks and corporate bonds) would reduce that perceived risk.

NALC urges the Commission 701 Report to recommend that Congress authorize investing the PSRHBF in a manner consistent with private sector best practice.

June 17, 2016

Respectfully submitted,

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ATTACHMENT 1

Attachment 1.

The Legacy of the PAEA: USPS Finances Since 2006 ($BILLIONS)				
Year	**USPS Reported Net Income/(Loss)**	**PSRHB Pre-Funding**	**Actuarial Adjustments for Workers' Comp and Other Liabilities**	**Operating Income/(Loss)**
2006 (pre-PAEA)	$0.9	$0.0	-$0.4	$1.3
2007	-$5.1	-$8.4	$0.1	$3.2
2008	-$2.8	-$5.6	-$0.2	$3.0
2009	-$3.8	-$1.4	-$1.1	-$1.3
2010	-$8.5	-$5.5	-$2.4	-$0.6
2011	-$5.1	$0.0	-$2.4	-$2.7
2012	-$15.9	-$11.1	-$2.4	-$2.4
2013	-$5.0	-$5.6	$0.3	$0.3
2014	-$5.5	-$5.7	-$1.2	$1.4
2015	-$5.1	-$5.7	-$0.5	$1.2
2016 (2Q)	-$1.7	-$2.9	-$0.6	$1.8
TOTAL Since PAEA	-$58.5	-$51.9	-$10.5	$3.9
	PSRHBF Percent of Total Losses	**89%**		

Source: USPS 10-K reports.

ATTACHMENT 2

SELECTED FEDERAL AND STATE FUND ALLOCATIONS AND RETURNS

Case Study: 2001 Reform of the Railroad Retirement Program

The Railroad Retirement and Survivor's Improvement Act of 2001 created the National Railroad Retirement Investment Trust ("NRRIT") to invest railroad retirement assets in equities and other private sector securities; previously assets invested only in government securities

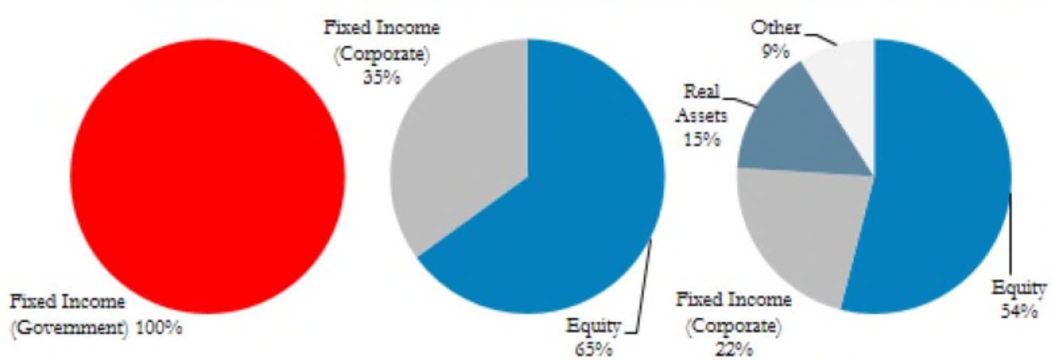
Rate of Return on Railroad Retirement Assets

Considerations in Changing Investment Allocation

- ✓ Plan funded by private-sector employees therefore investments should be expanded to private-sector securities
- ✓ Equity investments have higher expected returns over long term
- ✓ Any conflicts of interests can be eliminated through governance and policy
- — Government assets should not be invested in private sector securities
- — Potential for political influence on investment decisions
- — Formation of NRRIT could set a precedent for the reform of the Social Security program

RRB Target Asset Allocation

Pre-Reform | **2001 Initial Target Allocation** | **2011 Revised Target Allocation**



Railroad Retirement Investment Trust

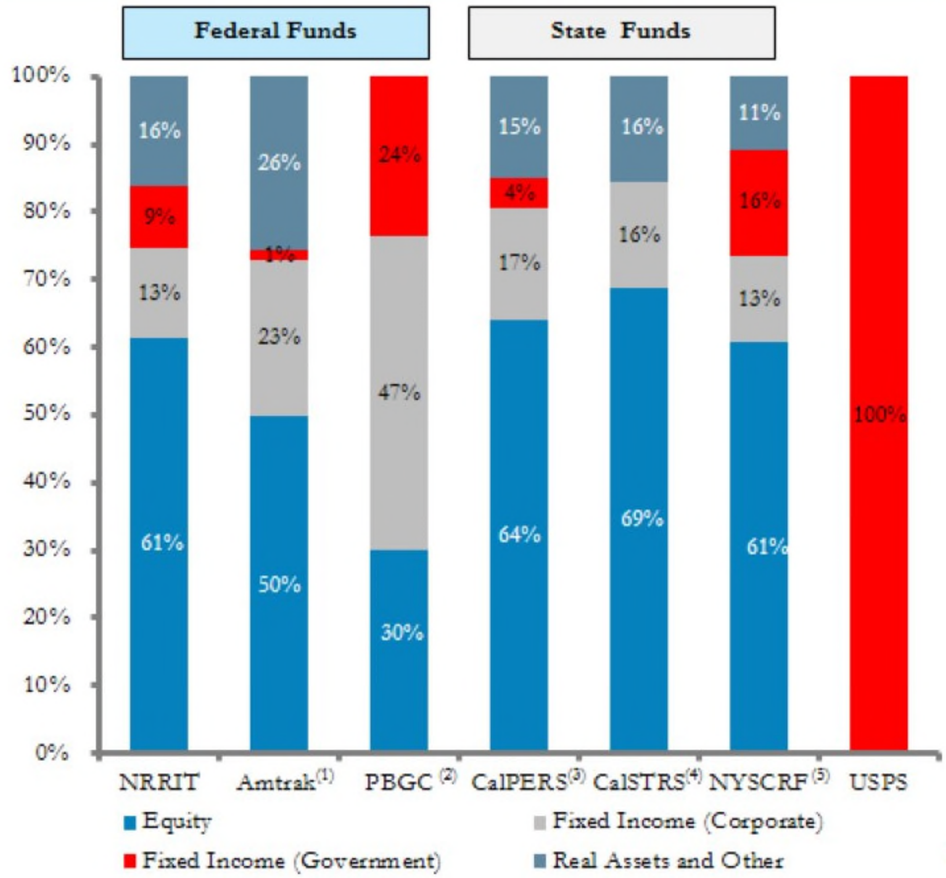
- Trust is explicitly not a government entity
- Board of Trustees consists of six private-sector trustees selected by labor and management, and one independent trustee
- Trustees must retain independent advisors to help formulate investment guidelines, and independent investment managers to invest the assets accordingly
- Investments must be diversified to minimize risk of large losses and to avoid disproportionate influence over a particular industry or firm; investment in securities issued by railroads

Source: NRRT Annual Reports; "An Assessment of the 2001 Reform of the Railroad Retirement Program," 2013 Center for Retirement Research Study (Boston College).

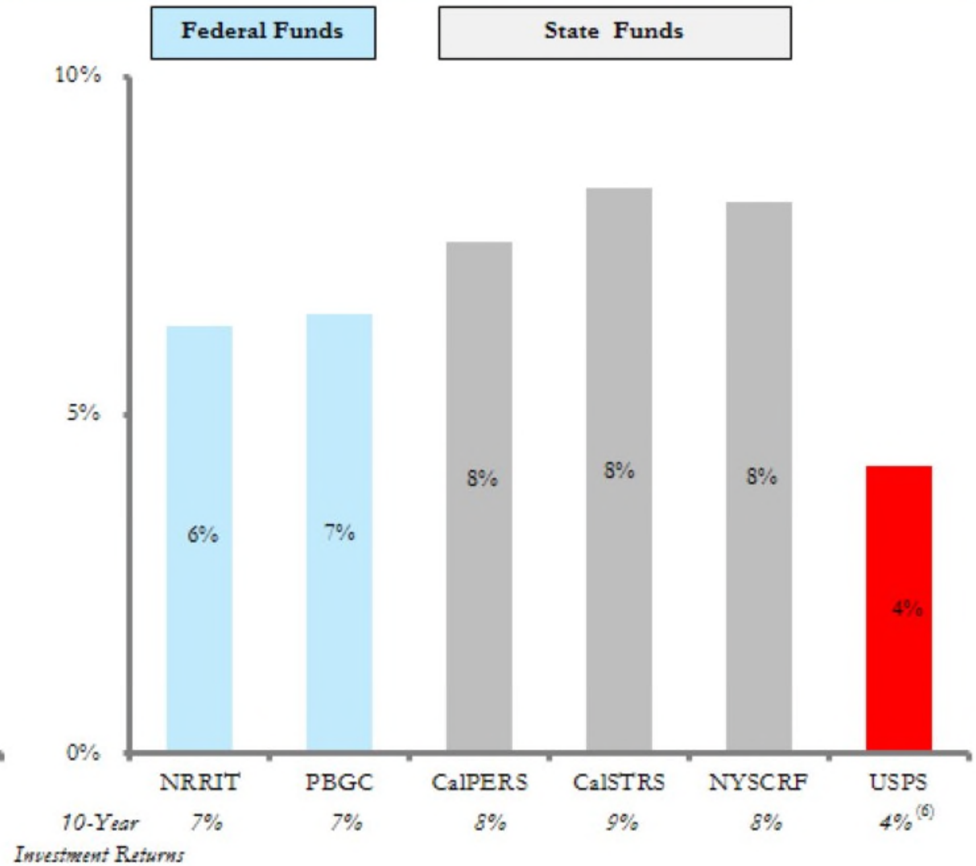
Most Recent Asset Allocation and Historical Returns of Various Funds

Major quasi-governmental pensions and other assets funds invest in diversified portfolios including corporate securities; average returns have exceeded that of the Postal Service Retiree Health Benefits Fund ("PSRHBF") since its inception in 2006

ASSET ALLOCATION



2006-2014 AVERAGE RETURNS[7]



Source: Annual reports and press releases, US News Global Asset Fund Allocation Guidelines.

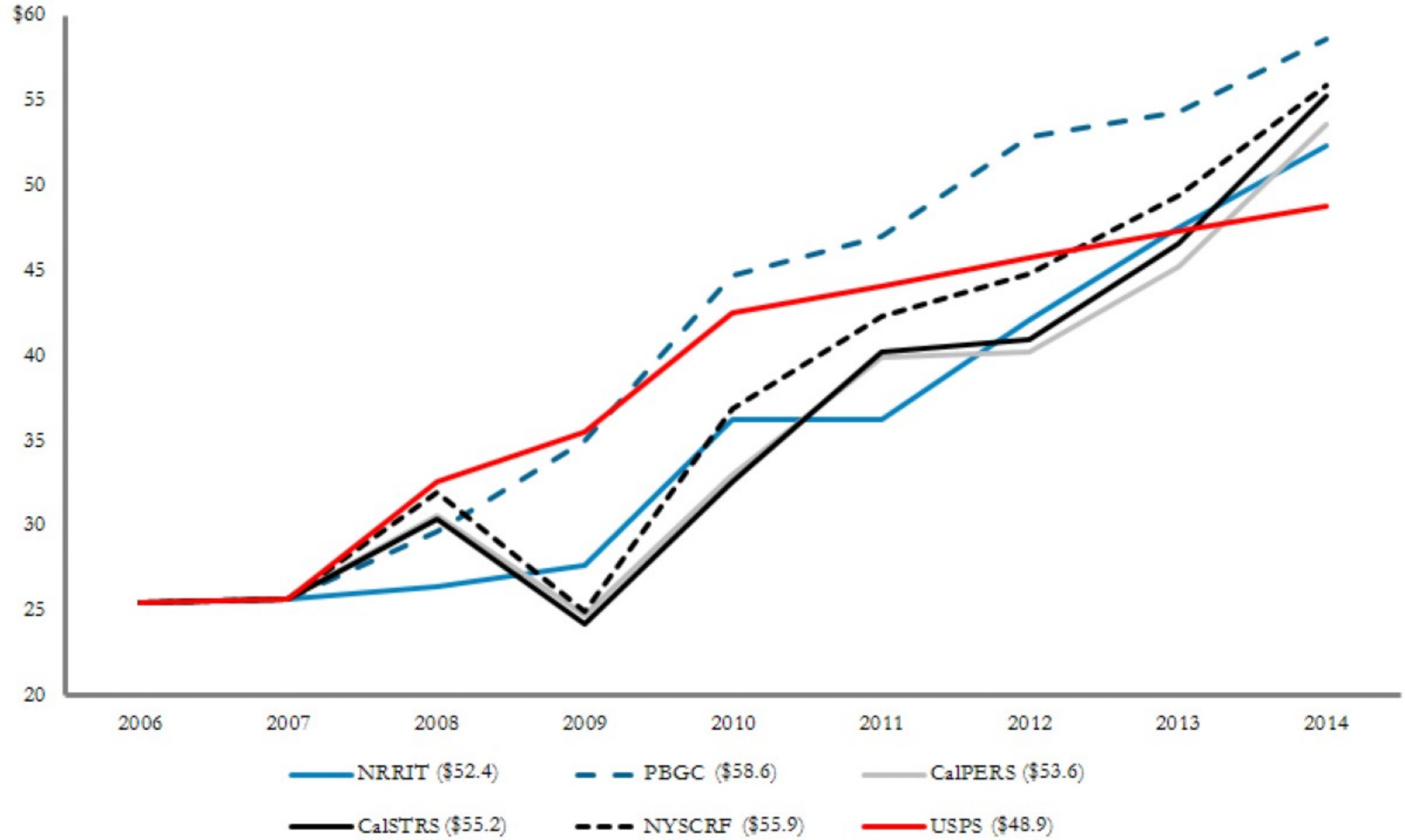
(1) Amtrak trust funds provide post-retirement benefits for non-unionized employees; total assets under management: $394m.
(2) PBGC (Pension Benefit Guaranty Corporation) guarantees pension benefits for American employees and retirees in ~24,000 plans; total assets under management: $81.5b.
(3) CalPERS (California Public Employees' Retirement System) is compromised of multiple-employer plans based in CA; total assets under management: $313.7b.
(4) CalSTRS (California State Teachers' Retirement System) provides pension benefits to California full-time and part-time public school teachers; total assets under management: $189.1b.
(5) NYSCRF (New York State Common Retirement Fund) provides benefits to 3,000 state and local government-participating employers; total assets under management: $181.3b.
(6) Figures for 2005-2006 reflect US Treasury returns.
(7) USPS transferred $3.0 billion into the PSRHBF on April 6, 2007, $17.1 billion on June 29, 2007, and $5.4 billion on September 30, 2007.

PSRHBF Assets over Time

($ in billions)

PSRHBF asset balance was $48.9 billion as of September 2014. If the PSRHBF had been invested similarly to selected other quasi-governmental funds since its inception, the balance would be between $52 and $59 billion

ILLUSTRATIVE PSRHBF BALANCES ASSUMING DIVERSIFIED INVESTMENT MIX (HYPOTHETICAL PSRHBF 2014 BALANCE IN PARENTHESES)



Note: Assumes diversification in asset allocation begin September 30, 2007.

Appendix

Appendix: Summary Metrics

($ in billions)

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	*8-Year Average*	*10-Year Average*
Illustrative PSRHBF Ending Balances Assuming Diversified Investment Mix (1)	**NRRIT**	-	-	$25.7	$26.4	$27.7	$36.2	$36.2	$42.1	$47.5	$52.4	-	-
	PBGC	-	-	25.7	29.7	35.0	44.7	47.0	52.9	54.3	58.6	-	-
	CalPERS	-	-	25.7	30.6	24.8	33.0	39.9	40.3	45.3	53.6	-	-
	CalSTRS	-	-	25.7	30.4	24.2	32.6	40.2	40.9	46.6	55.2	-	-
	NYSCRF	-	-	25.7	32.0	25.0	36.9	42.3	44.8	49.5	55.9	-	-
	USPS	-	25.5 (2)	25.7	32.6	35.5	42.5	44.1	45.7	47.3	48.9	-	-
	USPS PSRHBF Contributions and Transfers	-	-	-	5.6	1.4	5.5	-	-	-	-	-	-
Actual Fund Returns	**NRRIT**	14%	10%	16%	(19%)	(1%)	11%	(0%)	16%	13%	10%	*6%*	*7%*
	PBGC	9%	4%	7%	(7%)	13%	12%	5%	13%	3%	8%	*7%*	*7%*
	CalPERS	12%	12%	19%	(3%)	(24%)	11%	21%	1%	13%	18%	*8%*	*8%*
	CalSTRS	11%	13%	21%	(4%)	(25%)	12%	23%	2%	14%	19%	*8%*	*9%*
	NYSCRF	9%	15%	13%	3%	(26%)	26%	15%	6%	10%	13%	*8%*	*8%*
	USPS (3)	6%	5%	5%	5%	5%	4%	4%	4%	4%	3%	*4%*	*4%*

Notes:
Assumes diversification in PSRHBF asset allocation began September 30, 2007.
All pension funds have varying fiscal year ends: March (NYSCRF), June (CalPERS, CalSTRS), and September (NRRIT, PBGC, USPS).
(1) Ending Balances are calculated by applying selected fund return % to PSRHBF Beginning Balance and adding PSRHBF Contributions & Transfers for said year.
(2) Illustrative 2006 Beginning Balance is actual 2007 PSRHBF Contributions & Transfers figure. USPS transferred $3.0 billion into the PSRHBF on April 6, 2007, $17.1 billion on June 29, 2007, and $5.4 billion on September 30, 2007.
(3) 2005-2006 figures reflect US Treasury Returns.